

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 06-0358
Adjusted Gross Income Tax
For Tax Period 2002**

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Adjusted Gross Income Tax- Disallowed Business Expenses

Authority: IC § 6-8.1-5-1; IC § 6-8.1-5-4.

Taxpayer protests the Department's decision to disallow certain claimed business expenses.

II. Tax Administration- Ten Percent Negligence Penalty

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer operates a dry cleaning business as a sole proprietorship. After an investigation, the Indiana Department of Revenue (Department) assessed additional adjusted gross income tax, penalty, and interest against Taxpayer for the 2002 tax year. The Department's assessment disallowed certain expenses that Taxpayer had claimed as business expenses. Taxpayer protested the assessment. An administrative hearing was held and this Letter of Findings results.

I. Adjusted Gross Income Tax- Disallowed Business Expenses

DISCUSSION

Taxpayer filed income tax returns for the 2002 tax year and claimed a variety of deductions for business related expenses on the returns under IC § 45 IAC 3.1-1-3(1), which provides that the "trade and business deductions" that are "contained in Internal Revenue Code Section 62 are allowed in determining Indiana Adjusted Gross Income."

However, the Department disallowed a number of the expenses because Taxpayer failed to provide any documentation that demonstrated that the expenses were attributable to the Taxpayer's business.

IC § 6-8.1-5-4(a) provides:

Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.

Accordingly, it is Taxpayer's responsibility to retain the documentation that supports the amounts it used to determine the tax owed.

Taxpayer has provided sufficient documentation to demonstrate that the expenses listed below are business expenses that are eligible for deduction:

Employee wages; page 1 of 2002 Questions ("page 1"), payment amount \$135.88
Employee wages; page 1, payment amount \$30.09
Subcontracting; page 1, payment amount \$233.50
Checks; page 2 of 2002 Questions ("page 2"), payment amount \$77.30
Checks; page 2, \$102.11
Air Conditioning Service; page 2, \$146.95
Employer's Health Insurance; page 2, payment amounts \$142.07 and \$142.07
Office Space and Storage Rental; page 1, payment amounts \$131.25, \$262.50, \$262.50, \$131.25, \$131.25, and \$306.29.

Therefore, Taxpayer's protest, as it pertains to the above listed expenses, to the extent that tax was assessed is sustained subject to the findings of a supplemental audit.

In the course of the protest, Taxpayer submitted numerous invoices and check stubs. However, the documents submitted were insufficient to prove a business expense allowable under the Indiana Code for any of the expenses, which were not included in the above list. Moreover, Taxpayer did not cite any statute, regulation, or case law for the proposition that the auditor was required to accept Taxpayer's assertions as to the nature of these transactions without providing the supporting documentation. Pursuant to IC § 6-8.1-5-1(b), all tax assessments are presumed to be accurate, and the taxpayer bears the burden of proving that an assessment is incorrect. Since Taxpayer failed to produce any documentation that demonstrates that the Department's assessment was incorrect for these other expenses, then Taxpayer has failed to meet its burden to prove that the expenses were business expenses. Therefore, Taxpayer's protest, as it relates to these expenses, is denied.

FINDING

Taxpayer's protest is sustained in part and denied in part.

II. Tax Administration- Ten Percent Negligence Penalty

DISCUSSION

Taxpayer protests the imposition of the ten percent negligence penalty pursuant to IC § 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2(b) clarifies the standard for the imposition of the negligence penalty as follows:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The standard for waiving the negligence penalty is given at 45 IAC 15-11-2(c) as follows:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

In this case, taxpayer incurred a deficiency which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). While Taxpayer has established that it does not owe some of the proposed assessments discussed in Issue I, Taxpayer has not affirmatively established that its failure to pay the remaining deficiencies was due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is denied.